Information Technology Investment Board
Finance Committee

Wednesday, March 31, 2004
10:00 AM

VITA Operations Center – Executive Conference Roon
110 South Seventh Street
Richmond, Virginia 23219

AGENDA

I. Welcome and Introductions – Scott Pattison, Chair
II. Approval of Minutes
III. Finance Report
IV. JLARC proposals
    a. Direct bill methodology
    b. Shared methodology
V. Savings Methodology
VI. APA Action Plan Update
VII. Review of the Draft Business Plan
VIII. Other Business
IX. Public Comment
X. Adjourn

VIRGINIA INFORMATION TECHNOLOGIES AGENCY

SUMMARY OF ESTIMATED INTEGRATION COSTS & MEL

Directorate	Activity	MEL	Costs
Audit	Audit Staff	3	$353,300
Financial Management	Strategic Planning/Performance Metrics	1	$96,500
Financial Management	Finance and Accounting	1	$47,700
Financial Management	Budget, Planning and Analysis	4	$353,520
Financial Management	General Accounting & Billing	12	$856,940
Human Services	Human Resources	6	$636,552
Security	Security	2	$200,110
Supply Chain Mngt	Integrated Sourcing	7	$626,283
Supply Chain Mngt	Contract Systems and Operations	4	$357,876
Supply Chain Mngt	Contract Mngmnt/Development & Integration	3	$268,407
Supply Chain Mngt	Contract Management System		$200,000
Customer Support	VDOT large agency support		$536,000
Customer Support	Enterprise Service Directors	7	$819,000
Business Services	Asset Inventory/Tagging & Contract Abspn Spt	2	$563,678
Strategic Management	PPEA Support	2	$912,448
Computer Services	Facilities		$671,072
Computer Services	Workstations		$15,000
Financial Management	Central Payroll Costs		$90,000
		54	$7,604,386

Total MEL by Directorate	
Audit	3
Financial Management Services	18
Human Services	6
Security	2
Supply Chain Management	14
Customer Support	7
Business Services	2
Strategic Management Services	2
Total	54

Attachment 2

Virginia Information Technologies Agency
Methodology for Developing Product and Service Rates
For discussion at the ITIB Finance Committee meeting on March 31, 2004

Outcome Desired

Finance Committee and subsequent ITIB approval of the proposed methodology for developing product and service rates for shared services.

Purpose

This document defines the methodology VITA follows in the determination of charging models and the development of rates, specifically addressing the development of rates for shared services.

Overview

With few exceptions, the Virginia Information Technologies Agency (VITA) operates as a sum sufficient Internal Service Fund using accrual accounting. All expenses incurred to develop, deliver and administer products and services are recovered from the customer community through various charging models. Charges for each product or service are designed to recover the actual expenses incurred in providing the product or service. The remainder of this document defines VITA's methodology for developing rates for new services.

Business Case Process

Rate development begins with the preparation of a business case. VITA's business case policy (Attachment A) requires that proposed new services or major changes to existing services must be initiated by preparing a business case. VITA's business case procedure (Attachment B) specifies the required content of the business case document and cost analysis worksheet. At a high level, the information provided in the business case allows VITA to make informed business decisions by determining answers to questions such as:

- How much demand exists for the service?
- Should VITA be involved in providing the service?
- What is the best method for service delivery considering cost and benefit?
  - Service hosted or provided by VITA
  - Service outsourced to a third party
  - Service provided by developing a partnership with a third party
  - Service remains status quo

For purposes of rate setting, the most pertinent information provided in the business case is a description of the current environment and alternatives for providing the proposed service. The business case proponent is required to include the actual costs incurred to

support the current environment and cost projections related to each alternative presented. Cost information is provided in worksheet format and includes costs for hardware, software, facilities, personnel and other expenses. Once the descriptive and cost information provided by the proponent is determined to be comprehensive, VITA Financial Management Services finalizes the total cost of providing the proposed service under each alternative presented. The total cost and benefits are weighed against the current costs to determine the recommendation. VITA also begins to consider cost recovery alternatives, which can play a part in the recommendation.

Determining Total Cost

All expenses VITA incurs to provide services can generally be categorized as direct, shared or indirect. Direct expenses are those that can be identified and attributed to one specific service. For example, expenses for production printers, printer operators, printer maintenance and supplies are all in direct support of the print service. Shared expenses are those incurred by functions that generally provide support to more than one service and may be allocated proportionately or in some cases directly to appropriate services. Security and Capacity Planning are examples of shared expenses. Indirect expenses are those incurred for functions that generally support all services that VITA provides. Examples of indirect expenses include Human Resources, Payroll, Accounts Receivable and Accounts Payable. These expenses are generally allocated across all services based on an expense ratio or effort reporting.

The cost information provided in the business case is expected to address all direct expenses, in some cases shared expenses and in rare cases, indirect expenses. Financial Management Services will determine the remaining shared and indirect expenses not explicitly identified in the business case documentation. Once the remaining expenses are quantified, the total projected cost of providing the service is known. The total cost also becomes the amount VITA must recover through the charge-back process. In its simplest form in which the service is dedicated to a single customer, the total cost is charged directly to the customer receiving the service. This could be a one-time charge or a monthly recurring charge depending on the nature of the service. In many cases multiple customers will share the service, which dictates the need for development of a service rate.

Shared Services Rate Development

As mandated for an Internal Service Fund organization such as VITA, the first goal in developing a rate is to attempt to fully recover all costs associated with providing the service. While achieving full cost recovery, VITA attempts to adhere to several generally accepted best practice principles with respect to developing rates for shared services using an activity based costing methodology:

- At the top of the list is equitability. All customers must pay the same rate for the same service. Besides a good business practice, it is also

considered a federally unallowable expense (OMB Circular A-87) for one customer to subsidize another by virtue of inequitable charges.

- Charges should also be consistent or repeatable. Each time a service is provided or a single unit consumed, it should result in the same charge.
- Customers should be able to understand what they are being charged for and how the charge relates to the service they are receiving.
- Customers should have the ability to control their costs to the degree that less usage results in a lower charge and greater usage results in an increased charge.
- Finally, the data capture, processing, billing, collection and accounting for the charges should be economical relative to the cost of the service. A phrase we often hear is "don't spend dollars chasing after nickels".

Also a critical consideration to VITA for rate development is determining the unit or metric to use as the basis for the charge. In addition to the principles cited above, it is important that the unit for charging should also be a major driver of costs incurred to provide the service. Examples include:

- One of the oldest and most familiar metrics for charging is CPU time. Appropriately, increased consumption of CPU time is generally what drives the need for additional processors or an upgrade to a higher capacity CPU. In this case, there is a strong correlation between CPU time as a charging unit and as a cost driver.
- In the example of building a shared e-mail service, the number of e-mail accounts or mailboxes may be the primary cost driver resulting in a per account rate.
- Relatively new to IT is the possibility of sharing large servers with logical or physical multi-processor capabilities leading to a facilities management rate per processor.

Ultimately, a charge-back rate is simply a way to distribute the total cost associated with providing a service to the customers that use the service. There are many different charging models and no single model is a good fit for every service. Accordingly, for each new service proposal, VITA considers employing a variety of charging models to distribute the total cost including:

- Direct charge to a single customer when the service is dedicated
- Pass through of a vendor charge to one or more customers
- Negotiated allocation to multiple customers
- Measured allocation to multiple customers
- Subscription charge per account, seat, etc
- Connect charge
- Measured usage charge

Summary

While the charging model selected and the specific rate developed will vary from service to service, VITA utilizes, as described in this document, a consistent methodology and best practice principles to guide the rate development process.

Rate Development Example

The following narrative and spreadsheet reflects an example of developing a billable rate for a shared service. The project is hypothetical and the cost figures are for illustrative purposes only and are not intended to represent actual costs.

Hypothetical Project

VITA intends to develop a shared email service hosted at the RPB facility. The application will run under a Windows NT operating system. The service is initially intended to support small agencies in the Richmond metropolitan area. Over the next 3 to 4 years, some medium agencies are expected to be included in the service. The server is expected to have a 4-year life and will be depreciated accordingly. Initial expenses for software and other setup activities will also be spread over 4 years for projected recovery. Within 4 years, VITA projects a user population of 4,000. VITA was able to negotiate the most cost effective rate for licensing of the client software for a 5,000 seat license.

Estimated direct expenses for staff, hardware, software, facilities and other expenses have been provided by various functional areas within VITA. As the number of users or email accounts is the primary driver of costs, it has also been decided to use email accounts as the unit of measure for billing. Data capture of the email accounts for billing purposes will involve minimal expense as the necessary information can easily be obtained as a by-product of maintaining a table of valid accounts.

With the cost information available, the unit of measure for billing and the projected number of units available, determining the rate to charge per unit ($2.43) is accomplished with simple spreadsheet calculations as shown on the following pages.

Title: Shared Email Service Alt 1 - Host at VITA	One Time	Ongoing			
		Annual			
Item	0	1	2	3	4
Cost Category					
Hardware					
1 Windows NT server	$5,000	$0	$0	$0	$0
Maintenance	$0	$1,000	$0	$0	$0
Total Hardware Required	$5,000	$1,000	$0	$0	$0
Software					
Mail server license	$7,000	$700	$0	$0	$0
Mail client license for 5,000	$160,000	$40,000	$0	$0	$0
Client Veritas (for EBARS)	$0	$0	$0	$0	$0
Total Software Required	$167,000	$40,700	$0	$0	$0
Facilities Cost (enter units* below)					
Floor Space Sq. Ft. required*	0	8	0	0	0
Floor Space (Cost Analysis will calculate)	$0	$120	$0	$0	$0
Watts for Electrical Requirements		2850			
Watts required for A/C (cooling)		2850			
Electrical (Cost Analysis will calculate)	$0	$3,013	$0	$0	$0
Site Preparation - Elec and cable	$1,200	$0	$0	$0	$0
Other - Lockable Cabinet	$700	$0	$0	$0	$0
Total Facility Cost	$1,900	$3,133	$0	$0	$0
Other Category					
Network or Telco - 2 router port	$0	$2,340	$0	$0	$0
Backup 50 Gb monthly (EBARS)	$0	$164	$0	$0	$0
Other - 40 cartridges vaulted monthly	$0	$456	$0	$0	$0
Hot Site backup server (Sungard)	$0	$4,080	$0	$0	$0
Total Other Cost	$0	$7,040	$0	$0	$0
Total Non-Personnel Cost	$173,900	$51,873	$0	$0	$0
Personnel Hours Required **List Positions and No. of Hours**	0	1	2	3	4
1 NT Engineer support	8	36			
2 Email security administrator	6	24			
3 Capacity Planning support	6	24			
4 Networking support	4	12			
5 Operations support	6	24			
6 Security - Firewall support	4	12			
Personnel Costs	$384	$1,728			
	$288	$1,152			
	$288	$1,152			
	$192	$576			
	$180	$720			

	$192	$576
Total Personnel Costs	**$1,524**	**$5,904**

	Set Up	Annual
Total Cost	$175,424	$57,777
Set up costs spread over 4 years		$43,856
VITA's Annual Direct costs		$101,633
VITA Indirect Costs (+ 15%)		$15,245
Annual amount to recover		$116,878
Projected number of accounts		4,000
VITA's monthly rate per account		$2.43

Proposed Methodology for Identifying and Capturing Savings

For discussion at the ITIB Finance Committee meeting on March 31, 2004

Outcome Desired

Finance Committee and subsequent ITIB approval of the proposed methodology for identifying and capturing savings.

Overview

Based on the legislation regarding the Virginia Technology Infrastructure Fund[1], the CIO is to identify savings through a methodology approved by the IT Investment Board and the Secretary of Finance. In general, VITA identifies savings based on a comparison of costs before and after implementation of a new initiative. Initiatives resulting in savings may originate from negotiating lower vendor contracts for goods and services, from consolidation of services or from sharing of resources. VITA is committed to achieving savings of a sufficient amount to offset the overhead fee charged to agencies under the proposed direct bill approach, with any additional savings being withdrawn from the agencies and applied to the Infrastructure Fund.

Identifying Savings Estimates

Identifying savings begins with the preparation of a business case. VITA's business case policy requires that proposed new services or major changes to existing services must be initiated by preparing a business case. VITA's business case procedure specifies the

[1] § 2.2-2023. Virginia Technology Infrastructure Fund created; contributions.
A. The Virginia Technology Infrastructure Fund (the Fund) is created in the state treasury. The Fund is to be used to fund major information technology projects or to pay private partners as authorized in subsection B of § 2.2-2007.
B. The Fund shall consist of: (i) the transfer of general and nongeneral fund appropriations from state agencies which represent savings that accrue from reductions in the cost of information technology and communication services, (ii) the transfer of general and nongeneral fund appropriations from state agencies which represent savings from the implementation of information technology enterprise projects, (iii) funds identified pursuant to subsection B of § 2.2-2007, (iv) such general and nongeneral fund fees or surcharges as may be assessed to agencies for enterprise technology projects, (v) gifts, grants, or donations from public or private sources, and (vi) such other funds as may be appropriated by the General Assembly. Savings shall be as identified by the CIO through a methodology approved by the Board and the Secretary of Finance. The Auditor of Public Accounts shall certify the amount of any savings identified by the CIO. For public institutions of higher education, however, savings shall consist only of that portion of total savings that represent general funds. The State Comptroller is authorized to transfer cash consistent with appropriation transfers. Appropriated funds from federal sources are exempted from transfer. Except for funds to pay private partners as authorized in subsection B of § 2.2-2007, moneys in the Fund shall only be expended as provided by the appropriation act.
Interest earned on the Fund shall be credited to the Fund. The Fund shall be permanent and nonreverting. Any unexpended balance in the Fund at the end of the biennium shall not be transferred to the general fund of the state treasury.

required content of the business case document and cost analysis worksheet. One of the requirements for preparing a business case is the potential to achieve savings as a result of proceeding with an initiative.

For purposes of identifying savings, the most pertinent information provided in the business case is a description of the current environment and alternatives for providing the proposed service. The business case proponent is required to include the actual costs incurred to support the current environment and cost projections related to each alternative presented. Cost information is provided in worksheet format and includes costs for hardware, software, facilities, personnel and other expenses. Once the descriptive and cost information provided by the proponent is determined to be comprehensive, VITA Financial Management Services finalizes the total cost of providing the proposed service under each alternative presented. The total cost of each alternative is compared with the current cost to determine the potential savings.

Savings Capture

As savings are identified for initiatives that are implemented, VITA will track the cumulative savings amount. In FY05, all savings passed along to agencies via reduced charges will be retained by the agencies until such time as the cumulative savings amount equals VITA's total overhead costs for integration. Passing the savings back to agencies and allowing them to retain the savings is intended to offset the overhead fee. Once the cumulative savings equals the total annual overhead fee, additional savings will be captured by the Department of Planning and Budget by removing funds from agency budgets and transferring those funds to the Infrastructure Fund. The APA will certify all savings according to the legislation prior to any savings being removed from agency budgets.

Issues

Agencies will not benefit equally in all cases where savings are achieved. For example, agencies currently pay varying amounts for anti-virus software. VITA may negotiate a lower rate that results in statewide savings; however, the savings realized by each agency will vary based on the amount previously paid for the product.

Determining savings amounts by agency may be labor intensive. In the anti-virus example above, attempting to determine actual savings on an individual agency basis may involve manual research of contracts to determine the price each agency was previously paying for the product.

Some savings amounts cannot be accurately identified for each agency due to discretionary spending. For example, if VITA negotiates a lower rate for PCs, the actual savings will vary for individual agencies depending on the price previously paid (or currently budgeted) for the product. Additionally, there is no mandate for an agency to purchase any PCs in a given year making savings identification at the agency level impossible.

Next Steps

Once approved by the Finance Committee and the Board, the CIO will forward this savings methodology to the Secretary of Finance for approval.